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No. 1135

In the Supreme Court of the United States

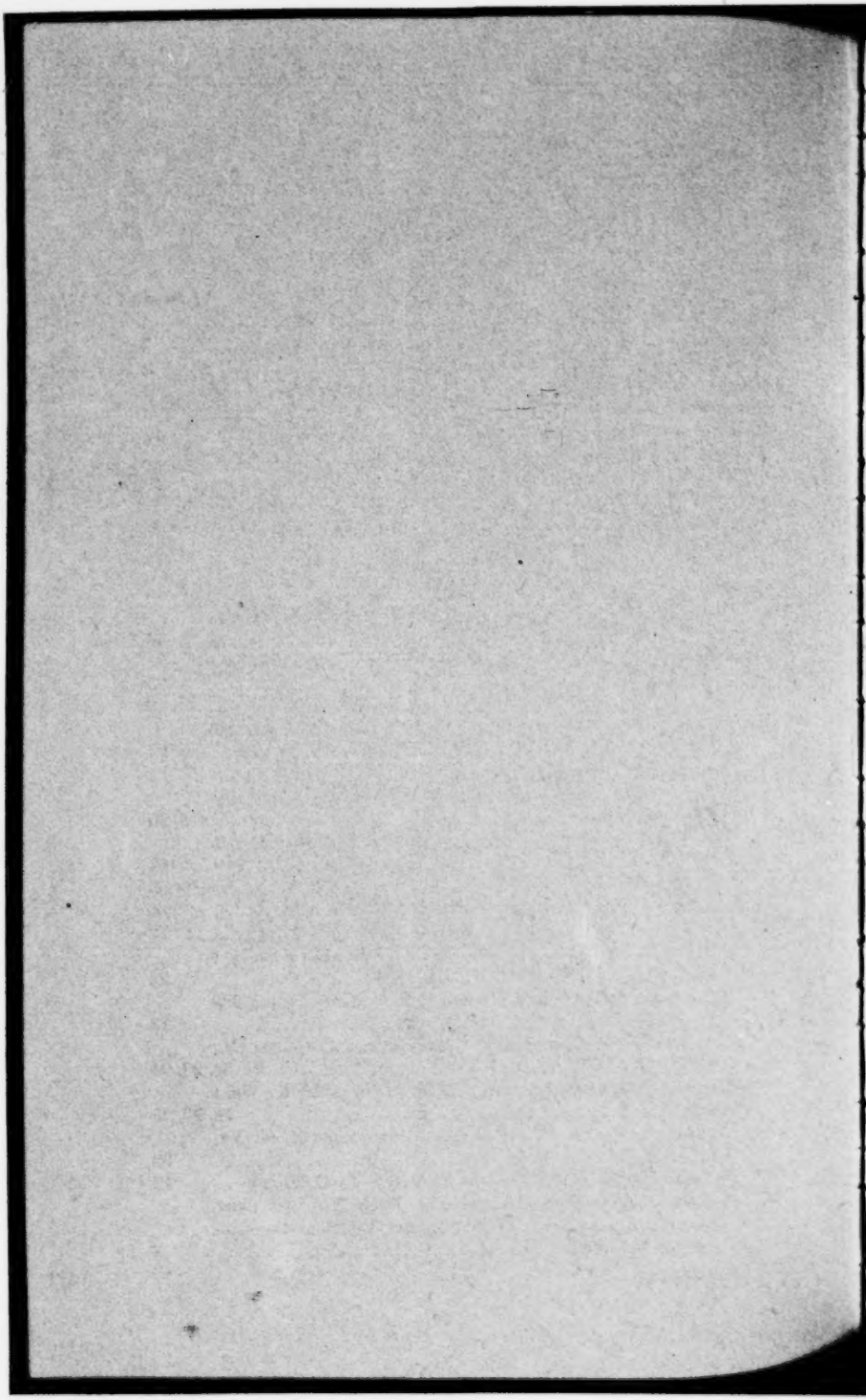
OCTOBER TERM, 1946

THE UNITED STATES, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA



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The Acting Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals of the District of Columbia entered in the above-entitled case on July 16, 1946.

OPINIONS BELOW

The opinion and order of the Public Utilities Commission of the District of Columbia (R. 1–46) are reported at 55 P. U. R. (N. S.) 65. The opinion of the District Court of the United States for the District of Columbia (R. 222) is not reported. The opinions of the United States Court of Appeals for

the District of Columbia (R. 658–664) is reported at 158 F. 2d 533.

JURISDICTION

The judgment of the Court of Appeals (R. 664) was entered on July 16, 1946. A petition for rehearing (R. 665–666) seasonably filed was denied on December 17, 1946 (R. 667). The jurisdiction of this Court is invoked under the provisions of Paragraph 65 of the District of Columbia Utility Law (D. C. Code 43–705, 37 Stat. 989, as amended by 49 Stat. 882)[1] and under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Over a period of years, the Potomac Electric Power Company has accumulated a surplus of approximately $29,000,000 which, the United States contends, being composed both of amounts resulting from improper and illegal depreciation practice and of the residue of exorbitant earnings remaining after distribution of excessive common stock dividends, represents involuntary customer

[1] Prior to the Act of August 27, 1935 (49 Stat. 882, c. 742, § 2) amending the Act of March 4, 1913 (37 Stat. 974, 989, c. 150, § 8, par. 65), it was held that the jurisdiction of this Court did not encompass review of decisions of the Court of Appeals for the District of Columbia on appeal from orders entered by the Public Service Commission. *Keller* v. *Potomac Electric Power Co.*, 261 U. S. 428. However, the limitations placed on the scope of judicial review in the courts below, by the Act of August 27, 1935, would appear to cure the objections to this Court exercising jurisdiction to review the decisions in such cases.

contributions to capital on which Pepco is not entitled to a return. The question presented is whether the Public Utilities Commission should have excluded such surplus, or a portion thereof, from Pepco's rate base and common stock equity.

STATUTES INVOLVED

The pertinent provisions of the District of Columbia Utility Law (37 Stat. 974, as amended by 49 Stat. 882, D. C. Code 43–101 *et seq.*), are set forth in Appendix B, *infra,* pp. 30–36.

STATEMENT

The factual background may be summarized as follows: The Potomac Electric Power Company (Pepco) was incorporated in 1896 (R. 608) and has had, as the result of consolidation with the competing electric light and power companies, a monopoly of the electric light and power business in the District of Columbia since 1902 (R. 335). Pepco came under regulation by the Public Utilities Commission of the District of Columbia (Commission) upon the passage of the Utility Law of March 4, 1913, 37 Stat. 974. Pepco's present capital structure consists of $40,000,000 of first mortgage bonds of varying maturities issued between 1936 and 1942 (R. 33); of $7,000,000 preferred stock, the sum of a 6% issue in 1925 and a 5½% issue in 1927, costing 5.86% annually (R. 34); and of $9,000,000 of $100 par value common stock (R. 35). Of this common stock $3,755,000

does not represent investment in used and useful property [2] and $3,000,000 of the remaining $5,245,000 was issued in 1942 for cash at par to Washington Railway and Electric Company (Wreco) (R. 592). Wreco is a holding company which has always owned all of the Pepco common stock (R. 274, 319, 336), and which in turn, is controlled by North American Company, a New Jersey corporation (R. 336, 345).

As of January 1, 1925, rate litigation which had been going on between Pepco and the Commission since 1917,[3] was terminated by the entry of a consent decree. This decree established the so-called "sliding scale arrangement," which provided a formula and procedure for fixing rates (R. 57-64). Briefly, the arrangement provides as follows:

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[2] $1,000,000 represents stock issued in 1912 for certain rights in a hydroelectric site located at Great Falls on the Potomac River. By its Order No. 208 of May 2, 1917, the Commission found that the interest in that site did not represent operating property, and ordered that it be carried in the non-operating property account (R. 35, 38, 591, 593). The remaining $2,755,000 has been found by the Commission not to represent cash, property or services received by Pepco, but to have been issued partly for purported services and partly for the absorbed companies in excess of their cost, and represented intercompany profit (R. 402–5). By Commission order this amount has been charged against surplus (R. 35, 36, 404).

[3] Phases of that litigation are officially reported in *Potomac Electric Power Co.* v. *Public Utilities Commission*, 276 Fed. 327 (App. D. C.) and *Keller* v. *Potomac Electric Power Co.*, 261 U. S. 428.

1. The "fair value of property now used and useful as of January 1, 1925, of $32,500,000" was determined as the rate base (R. 58) to which there was to be added annually the "actual cost of future additions undepreciated but weighted during a period of any one year" (R. 58–59);

2. Rates were to be fixed to yield a 7½% rate of return on the undepreciated rate base plus the annual additions (R. 58);

3. A depreciation reserve of $4,000,000 as of January 1, 1925, was established. The annual depreciation rates were to vary, in accordance with the percentage ratio of the reserve to the rate base, the total reserve never to exceed 20% of the rate base. Four percent interest was to be accrued on the reserve, to be treated "as an accretion to the reserve, lessening the amount of depreciation to be included as an expense of operation" (R. 58);

4. The rates were to be revised annually upward or downward in accordance with a prescribed formula. In regard to decreases it was provided that when the "rates * * * yield more than a 7½% return" on the undepreciated rate base, "one-half of said excess shall be used in a reduction of rates to be charged * * * thereafter, * * * that is to say, by way of example, * * *, the rates * * * shall be automatically reduced by the filing of new rate schedules to absorb

[one-half] of such excess during [the succeeding] year" (R. 58–59).[4]

Rates in the District of Columbia have been reduced under the formula to a level which compares favorably with rates for other cities of comparable size (R. 6). However, in administering the sliding scale arrangement, the Commission included in the rate base not only new additions to the plant but an allowance for working capital and for materials and supplies (R. 12) and applied reductions to gross revenues, rather than to net returns (R. 41). Moreover, there have been substantial earnings in excess of the rate of return in every year but one since 1925 despite annual rate reductions and reductions in the rate of return to 7% in 1931, to 6½% in 1935 and to 6% in 1937 (R. 7). The excess earnings, as found by the Commission, total approximately $16,000,000 for the period here involved, an average of well over $800,000 per year (R. 8). The Commission has never attempted to recapture any portion of the excess earnings and has always left such ex-

[4] In regard to rate increases, the sliding scale arrangement provided "If the average return for any consecutive 5-year period falls below 7½ percent on the base ascertained as aforesaid, or if the average return for any consecutive 3-year period falls below 7 percent on the base ascertained as aforesaid, or if the average return for any consecutive 12-month period falls below 6½ percent on the base ascertained as aforesaid, the commission shall promptly increase rates so as to yield 7½ percent on the base ascertained as aforesaid" (R. 59). In this connection, it should be noted that increases were to be such "as to yield 7½% on the base."

cess, in addition to the established return on the rate base, with Pepco. Instead, in accordance with its construction of the sliding scale arrangement, the Commission, in adjusting rates for each year, has sought to fix rates which would yield the established return plus one-half of the excess of the past year.[5]

On April 26, 1943, the Commission instituted an investigation as to whether the sliding scale arrangement should be abandoned, continued, or modified, and, if modified, what changes should be made in the basic elements thereof (R. 1). Ex-

[5] In 1931 the Commission in its Order 919 found that "the rate of return yielded by the existing sliding scale is excessive and unreasonable" and reduced the established rate of return from 7½% to 7%. The Commission in that order also amended the language of the sliding scale in regard to reductions in rate to the public to read as follows:

> If the said excess [over 7%] shall be not more than 1% of the rate base, returns from the following 12 months based upon the business done during the 12 months in which such service occurred shall be adjusted so that the gross receipts of the company shall be reduced by one-half of such excess.

The order provided a schedule of brackets for reductions which was to increase as excess earnings over the basic return increased. The consequent litigation, entitled *Potomac Electric Power Company* v. *Public Utilities Commission*, Equity No. 53475 in the Supreme Court for the District of Columbia, was compromised while appeal was pending in the Court of Appeals, and provided, *inter alia*, that the percentage of earnings to be used in the reduction of rates should vary from one-half to five-sixths of such excess depending upon the actual earnings of the company. This latter schedule has been continued to the present time.

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tensive hearings were had in which the United States, through the Federal Works Agency and the Procurement Division of the Treasury Department, participated as a customer of Pepco.

On July 22, 1944, the Commission entered its Order No. 2796 (R. 45–46)—the order here involved—which made various changes in the sliding scale arrangement and other material adjustments.[6] Instead of computing the return on an undepreciated rate base and accruing 4% interest on the depreciation reserve (*supra,* p. 5), the Commission adopted a depreciated rate base to which the rate of return was to be applied. The gross rate base, as of December 31, 1943, was fixed at $98,615,-839.52[7] (R. 21, 42). To this was added an allowance for materials and supplies, but no allowance for working capital was made since the lag in the payment of expenses and taxes exceeded the lag in the collection of revenue (R. 20–21). From this total was deducted as accrued depreciation the amount of $17,844,120, which was in the depreciation reserve on December 31, 1943 (R. 26). In lieu of the sliding scale provisions for annual charges for depreciation (*supra,* p. 5), the Commission fixed the annual depreciation expense on

[6] Only two Commissioners concurred. Commissioner Hankin's term of office expired before the order was issued, but he had previously filed a dissenting opinion which substantially supports the position of the United States (R. 66–209).

[7] In adopting this figure as the gross rate base, the Commission eliminated $5,581,713.76 as being in excess of the original cost of the property included therein (R. 13).

the basis of the estimated average service lives of various classes and groups of depreciable property (R. 26, 29).

The Commission used the cost-of-capital method of determining the basic rate of return. It found that the effective interest rate on the $40,000,000 of bonds was 3.008% (R. 33, 38); that although the annual cost of the preferred stock was 5.86%, it was refundable at 5% and hence allowed only 5% (R. 34); and that return of 8% on the common stock equity constituted a liberal return and was commensurate with returns on investments in other enterprises having corresponding risks (R. 37). On this basis, it found 5.319% to be the cost of capital, and hence reduced the basic rate of return to 5.5% (R. 38), which together with the excess allowed under the sliding scale arrangement amounts to 5.82% (R. 40). In applying the rate reduction, the Commission required it to be reflected in the net, rather than gross, operating revenues. As a result of these modifications and the computations pursuant thereto, the Commission directed Pepco to file new rate schedules which, when applied to KWH consumption during the test year 1943, would reduce its net income by $257,214.77 (R. 43). This, plus the savings of $779,974.51 in federal income and excess profit taxes resulting from the reduction in net income, resulted in a total rate reduction of $1,037,189.28 (R. 43).

The Commission treated the common stock as amounting to $8,000,000 (the total issued less $1,000,000 for the contract rights to the Great Falls hydroelectric site), the surplus at $29,433,544, and the common stock equity as the sum of these items, namely, $37,440,115[8] (R. 38). It refused to exclude the $29,000,000 surplus, or a portion thereof, from the rate base and the common stock equity as urged by the United States (R. 15–17). The Commission further found that after payment of bond interest and common stock dividends, there would remain $3,250,058.78 to provide a 8.91% return on such common stock equity (R. 43). Such return, the Commission found, would "enable Pepco to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed" (R. 43).

Applications for reconsideration were seasonably filed with the Commission on behalf of the United States (R. 227, 232) and denied by the Commission (R. 231, 236). A "Petition of Appeal" was filed in the United States District Court for the District of Columbia (R. 47) which that court dismissed on the merits (R. 221.).[9] Upon appeal, the Court of Appeals affirmed the judg-

[8] The slight discrepancy between the common stock equity and the sum of the common stock and the surplus is due to minor adjustments which are not here relevant.

[9] The appeal of the United States was initially opposed in the district court on the ground that the United States as a consumer was not "affected" by Order No. 2796 and hence was without standing to seek review thereof. On appeal,

ment of the district court. It held that while "There is no question but that the Company's rates outran the Commission's efforts to cut them down under the 'sliding scale' as it has operated for the past several years [and] * * * the Commission, as a matter of working policy, should have cut more deeply with its adjustments in the 'allowable rate of return' * * *, all of this justifiable criticism represents nothing more, in our opinion, than an attack, on an 'error in judgment' by the regulatory body. Such an error does not rise to a level of an error of law" (R. 660). It rejected the contention that the $29,000,000 surplus should be excluded from the rate base, stating "We are not directed to any authority for the government's position, and we have not been able to find any. On the contrary, there is a clear line of authority holding that surplus devoted to the Company's business is properly to be considered a part of the 'invested capital' " (R. 661). The court found that contention objectionable for the further reason that "The annual orders which fixed the rates became final and conclusive when no person affected availed himself of the right to appeal. Consequently the rates so fixed became the legal rates for the periods during which they were to endure, and neither the United States nor other party affected thereby can brand them as

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the Court of Appeals sustained the right of the United States to such review. *United States* v. *Public Utilities Commission*, 151 F. 2d 609 (App. D. C.).

illegal" (R. 662). Mr. Justice Edgerton dissented.[10]

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In failing to hold that the surplus was comprised of involuntary consumer contributions upon which Pepco is not entitled to a return.

2. In holding that the Commission, in fixing Pepco's rates, was without power to exclude the surplus here involved from the rate base and the common stock equity.

3. In holding that the rates charged under the sliding scale arrangement despite the exorbitant earnings resulting thereunder, may have been just and reasonable.

4. In failing to hold that the rates which gave rise to these earnings were invalid because they "woefully neglected the interests of the consumers."

5. In holding that the United States is now estopped from objecting to the inclusion of the surplus in the rate base and the common stock equity because of its failure to appeal prior rate orders.

6. In affirming the judgment of the district court.

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[10] Pepco has also sought judicial review of Order No. 2796. The district court dismissed Pepco's "Petition of Appeal" (R. 261) and the Court of Appeals affirmed (R. 646). Pepco has filed a petition for writ of certiorari in this Court (*Potomac Electric Power Co.* v. *Public Utilities Commission et al.*, No. 1038, this Term), which is now pending.

REASONS FOR GRANTING THE WRIT

The Commission, over the objection of the United States, included in the rate base or stockholders' equity $29,000,000 of surplus which Pepco accumulated over a period of approximately nineteen years out of excessive earnings after paying exorbitantly high dividends. We think it plain that the Commission acted, and the court below affirmed that action, on the erroneous assumption that, as a matter of law, exclusion of the surplus could not be sustained. It is our view that, on the contrary, the Commission was under a legal duty to exclude such surplus in complying with the statutory mandate to approve only just and reasonable rates. But regardless of whether the law compels exclusion of that surplus, the Commission certainly had power to exclude from the rate base a surplus representing payments by the rate payers over and above just and reasonable charges for utility service. In view of the very substantial injury done to the interests of consumers, which will otherwise progressively increase in the future, we submit that this Court should correct the errors of law in the decisions below and remand the case for further proceedings.

1. It is uncontroverted that from January 1, 1925, when the sliding scale arrangement went into effect, until December 31, 1943, the end of the test year used by the Commission as the basis of

Order No. 2796, Pepco has had excess earnings, over and above the established rate of return, in the amount of $16,911,533.49, an annual average of $890,080.71 (R. 8). As appears in Table I, Appendix A, *infra,* pp. 26–27, the net income available for common stock dividends, after payment of interest on bonded indebtedness and dividends on the preferred stock, has ranged from 42.07% to 75.14% per year (an average of 59.99% per year) on stock having a par value of $6,000,000 and from 72.19% to 200% (an annual average of 156.06%) on the actual investment of $2,245,000.[11] That Table further shows that the annual dividends actually paid in these years ranged from 14% to 65% (an average of 38.31%) on the par value of the outstanding common stock, and from 37.41% to 173.71% (an average of 99.16%) on the actual investment. In the 19-year period involved, common stock dividends have averaged more than $2,300,000 a year and have totaled $45,345,000 on an investment, which for practically 18 years of that period totaled no more than $2,245,000. Thus, the average dividends paid each year have more than equalled Wreco's total actual investment during most of that period. Despite the payment of such dividends, the common stock

[11] The par value of Pepco's outstanding stock was $6,000,000 from 1925 through June 1942, and $9,000,000 thereafter. The actual investment was $2,245,000 from 1925 through June 1942, and $5,245,000 thereafter. *Supra,* pp. 3–4.

equity has increased from approximately $8,000,000 in 1925 to $38,000,000 in 1943.

The Commission and the court below held that the Commission is without power to exclude from the rate base and the common stock equity Pepco's surplus of approximately $29,000,000, which has remained after the payment of these dividends. The effect of this holding is to require the customers who have already repaid Wreco, which owns all of Pepco's common stock, its investment many times over, and who by payment of excessive rates have contributed involuntarily at least the amount of this surplus, to pay rates which will allow Pepco a return not only on the par value of its common stock, but on this surplus as well. As pointed out by Justice Edgerton in his dissent in the instant case, notwithstanding the $1,037,189 rate reduction prescribed,[12] Pepco is permitted under Order No 2796 "to earn in a single year a return upon its common stock equal to more than one-third of the par value of the stock and more than one-half the amount which it received for the stock and invested in plant" (R. 663). Such a result, we submit, does not involve a true "balancing of the investor and the consumer interests" (*Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591, 603) and should not be

[12] $779,974.51 of this rate reduction represents savings in federal income and excess profits taxes, resulting from a prescribed reduction in net income of $257,214.77.

permitted without authoritative decision from this Court.

2. Before the Commission, the United States urged that the $29,000,000 surplus, being comprised of amounts resulting from improper and illegal depreciation practices and of the residue of exorbitant earnings remaining after the distribution of excessive common stock dividends, constituted an involuntary customer contribution to capital, on which Pepco was not entitled to a return, and hence should be excluded from the rate base and the common stock equity. The Commission, however, refused so to treat that surplus because, as it said, "The elimination of earned surplus or undistributed earnings from invested capital finds no support in reason or in law. On the contrary, it is universally recognized by both courts and regulatory authorities that undistributed earnings invested in the assets of a corporation are just as much a part of invested capital as are the dollars obtained from the sales of securities" (R. 15–16). The court below affirmed the Commission's action (R. 661).[13] The United States submits that the

[13] Contrary to the implication of the court below (R. 661–662), there is no question here involved as to the propriety of including in the rate base, surplus, which represents an accumulation of fair and reasonable earnings which the investors have decided to reinvest in the enterprise, rather than to withdraw in the form of dividends. It is this type of reinvestment which the Securities and Exchange Commission assumed it was discussing in the language quoted in the decision below (R. 661–662). See *Re Potomac Electric Power Company*, 8 S. E. C. 30, 36.

Commission erred as a matter of law in holding that it had no authority to exclude Pepco's surplus from the common stock equity.[14]

a. That Pepco's surplus represents amounts accumulated as the result of illegal and improper depreciation practices and of exorbitant earnings remaining after distribution of excessive common stock dividends is demonstrable.

In regard to Pepco's earnings, the Commission initially fixed the rate of return at 7½% and subsequently reduced it to 7% in 1931, to 6½%, and to 6% in 1937. That these rates of return set by the Commission were just and reasonable and adequately protected the interests of the investor is clear. This Court in 1933 upheld the sufficiency of a 7% rate of return (*Wabash Valley Electric Co.* v. *Young,* 287 U. S. 488, 502; *Los Angeles Gas & Electric Corp.* v. *R. R. Commission,* 289 U. S. 287, 319), and in 1938 it upheld, in *Driscoll* v. *Edison Light & Power Co.,* 307 U. S. 104, 120, the sufficiency of a 6% rate of return for enterprises, the risk of which was at least commensurate with, if not greater than, the risk here involved. See *Potomac Electric Power Co.* v.

[14] Paragraph 66 of the Utility Law, Appendix B, *infra,* p. 36, limits judicial review to "questions of law." The statement of the court below that although the Commission was validly subject to criticism for failing more vigorously to drive down Pepco's rates, such criticism represents nothing more than an attack on an "'error in judgment' * * * [which] does not rise to the level of an error of law" (R. 660), misconceives the error of law which the United States urged.

Public Utilities Commission, 158 F. 2d 521, 524 (App. D. C.), petition for writ of certiorari pending, No. 1038, this Term; Bussing, *Public Utility Regulation and the So-Called Sliding Scale* (1939), pp. 143–161. Despite the reasonableness of these rates of return, the Commission found that Pepco has earned, since January 1, 1925, approximately $16,000,000 in excess thereof (R. 8), and its Order No. 919 issued in 1931 recognized that the "rate of return yielded by the existing sliding scale is excessive and unreasonable" (ftn. 5, p. 7, *supra*).

The actual excess earnings are many millions of dollars greater since according to Commission practice that portion of the annual excess which is not distributed as dividends was immediately added to the rate base, which, as thus increased, was the basis used in determining whether and by how much the earning of subsequent years was excessive. These excessive earnings have resulted, we submit, from the fact that due to persistent errors of prediction or to persistent errors of interpretation by the Commission, the sliding scale arrangement has only nominally, but never effectively, been applied.[15] See Order No. 2564 of the

[15] The errors which, we believe, led to these excessive returns are (1) failure of the Commission to require recapture in some way, or the actual "absorption" of, any part of the annual excesses; (2) applications of reductions to gross, rather than net, income, which became important with the incidence of high federal taxes; (3) the illegal depreciation practices discussed, *infra*, pp. 19–21; (4) the assumption in fixing rates for each new year that operating volume and expenses would

Public Utilities Commission of the District of Columbia, dated April 26, 1943 (R. 567–573). Such earnings indicate plainly that the rates which produced these earnings were excessive (*Dayton-Goose Creek Ry.* v. *United States,* 263 U. S. 456, 483). Since the rates were excessive, they were unlawful and violative of Paragraph 2 of the Utility Law (Appendix B, *infra,* p. 30), which provides that all charges "shall be reasonable, just and nondiscriminatory. Every unjust or unreasonable or unreasonable or discriminatory charge * * * is prohibited and is hereby declared unlawful."[16] Moreover, being in excess of just and reasonable rates, they returned to Pepco more than was required to reimburse it for the service rendered, and accordingly, the excess represents involuntary customer contributions to the enterprise. Cf. *Re Hope Natural Gas Company,* 44 P. U. R. (N. S.) 1, 12, 40; *Re Mondovi Telephone Company,* P. U. R. 1933 B (Wis.) 319, 322.

In regard to depreciation, Paragraph 16 of the Utility Law, Appendix B, *infra,* pp. 30–31, provides:

> * * * every public utility shall carry a proper and adequate depreciation account

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remain static (but see Bussing, *supra,* at pp. 143–161; Barnes, *The Economics of Public Utility Regulation* (1942) p. 237); (5) the addition of the annual excesses to the rate base and the common stock equity.

[16] These rates also violated that provision of Paragraph 18 of the Utility Law, Appendix B, *infra,* pp. 31–32, that no sliding scale or similar arrangements shall be lawful unless it be "practicable and advantageous to the parties interested."

> The commission shall ascertain and determine what are the proper and adequate rates of depreciation of the several classes of property of each public utility. * * * All moneys in this fund may be expended in keeping the property of such public utility in repair * * *, and, if invested, the income from the investments shall also be carried in the depreciation fund.

Despite these provisions, the sliding scale arrangement established a single rate of depreciation for the entire rate base in which certain nondepreciable items such as land and working capital were included even for depreciation purposes (R. 12, 35, 58). But more important still, under the sliding scale arrangement, the money paid into the reserve was reinvested in the plant and added to the undepreciated rate base. Although the rate of return on this rate base was initially established at 7½%, and subsequently reduced progressively to 6%, Pepco was never required to pay more than 4% on the money in the depreciation reserve and was permitted to retain the difference between the 4% charge and the rate of return allowed thereon as a result of inclusion in the undepreciated rate base. Clearly, then, the provisions of the sliding scale arrangement violated the basic depreciation principles established in Paragraph 16 of the Utility Law, which the Commission and Pepco were without power to ignore even when agreeing upon a sliding scale arrangement as permitted by Paragraph 18. Accordingly,

the differential between 4% and the rate of return allowed represents an unearned increment contributed by Pepco's customers. Cf. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 595–596. Table II, Appendix A, *infra*, p. 28, shows that as a result of such depreciation practice, Pepco's surplus has been enhanced by approximately $9,000,000 since 1925. Moreover, as has been already pointed out, the rate of return which Pepco actually realized each year was greatly in excess of the rate of return established by the Commission, thereby increasing substantially the unearned increment accruing to Pepco as the result of this practice. Table III, Appendix A, *infra*, p. 29, shows enhancement of surplus in the amount of approximately $16,000,000 when interest is computed at the rate of return actually earned.

b. Thus, Pepco's surplus plainly is comprised of amounts resulting from improper and illegal depreciation practices and of the residue of excessive earnings remaining after the payment of excessive common stock dividends, and hence consists of involuntary customer contributions to capital. The Commission, we submit, should have excluded such contributions from the rate base and the common stock equity.

Although this Court has never passed on the exclusion of such contributions when they have appeared in the surplus account, this question was expressly reserved in *Louisiana R. R. Commission*

v. *Cumberland Telephone Co.*, 212 U. S. 414, at 425, and there is a respectable body of authority sanctioning such exclusion when as a result of improper depreciation practices, the depreciation reserve itself has become grossly excessive. See, e. g., *Louisiana R. R. Commission* v. *Cumberland Telephone Co., supra,* at 424–425; *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 158–159; *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, 168–169, 175; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, 597, n. 5, 599, 643, 644; *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* at 592–593; *Natural Gas Co.* v. *Public Service Commission*, 95 W. Va. 557, 571–572; *Re Mondovi Telephone Company*, P. U. R. 1933 B (Wis.) 319, 322; *Logan* v. *Bismarck Water Supply Co.*, P. U. R. 1923 B (N. D.) 450, 497–498; 2 Bonbright, *Valuation of Property*, 1139. As pointed out in the *Cumberland Telephone Co.* case, *supra,* "That it was right to raise more money to pay for depreciation than was actually disbursed for the particular year there can be no doubt, * * * but to raise more than money enough for the purpose and place the balance to the credit of capital upon which to pay dividends cannot be proper treatment" (212 U. S. at 425). That is so because "Customers who have unwittingly been financing property additions [by charges to operating expenses made by the company for capital additions] should not be expected to pay

rates which will allow a return on the property so paid for." *Re Mondovi Telephone Company, supra,* at 322. "[To make an allowance of amortization in excess of cost] would not be the computation of a proper expense, but instead the allowance of additional profit over and above fair return. Manifestly such an additional return would unjustly penalize consumers." *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* at 593, quoting with approval the opinion of the Federal Power Commission. This reasoning, we submit, is applicable irrespective of the particular account in which the contributions appear.[17]

Moreover, it is basic that an investor in a utility is entitled solely to a return on his actual investment, *Louisiana R. R. Comm.* v. *Cumberland Telephone Co., supra,* at 425; *Re Hope Natural Gas Company,* 44 P. U. R. (N. S.) 1, 12, 40; cf. *Federal Power Commission* v. *Natural Gas Pipe Line Co., supra,* at 590–591; *Southwestern Bell Telephone Co.* v. *Public Service Commission,* 262 U. S. 276, 290, 291 (Brandeis, J., dissenting) and not to any return on property constructed and financed

[17] *Board of Public Utility Commissioners* v. *New York Telephone Co.*, 271 U. S. 23, is not inconsistent with this position, since in that case, the Commissioners had directed the company to make up current losses out of reserves accumulated in the past. No question was raised there in regard to excluding from the rate base or common stock equity involuntary customer contributions. Cf. *Smith* v. *Ill. Bell Telephone Co.*, 282 U. S. 133, 158; *Wheeling* v. *Natural Gas Co.*, 115 W. Va. 149.

by customer contributions. *Louisiana R. R. Comm.* v. *Cumberland Telephone Co., supra,* at 424 *et seq; Lindheimer* v. *Illinois Bell Telephone Co., supra,* at 169, 174; cf. *Detroit Edison Co.* v. *Commissioner of Internal Revenue,* 319 U. S. 98. Apparently, for that reason the Commission in the present case without discussion excluded from the rate base voluntary contributions made in aid of construction (R. 21). The fact that the customers have made these contributions involuntarily as a result of being charged illegal rates, rather than voluntarily, does not provide a rational basis for treating the two situations differently.

c. The fact that no appeal had been taken from the Commission's annual rate orders and the rates there set became the legal rates, is not an obstacle to the present exclusion of the $29,000,000 surplus from the rate base and the common stock equity. While the rates were legal in the sense that Pepco could not depart therefrom, (Paragraphs 24 and 30 of the Utility Law, Appendix B, *infra,* pp. 32–33), they nevertheless were unlawful inasmuch as they were "unjust [and] unreasonable" and violated Paragraph 2 of the Utility Law. "In other words, the legal rate was not made by the statute the lawful rate—it was lawful only if it was reasonable." *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Ry. Co.,* 284 U. S. 370, 384. Moreover, the United States is not seeking to upset these past rates, but rather, to assure

that the rates presently fixed are just and reasonable. As Justice Edgerton, dissenting, points out, "history has an important bearing on what is presently fair" (R. 663). Cf. *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 158.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

GEORGE T. WASHINGTON,
Acting Solicitor General.

MARCH 1947

APPENDIX A

TABLE I

Year	Common-stock equity [1] (weighted) (stock and surplus)	Income available for common stock	Common-stock dividends	Percent of earnings on—			Percent of dividends on—		
				Common-stock equity	Par value [2]	Investment [3]	Common-stock equity	Par value [2]	Investment [4]
1925	$8,126,886.45	$2,598,289.50	$840,000.00	31.97	43.30	115	10.34	14.00	37.41
1926	10,042,743.09	2,799,940.62	960,000.00	27.88	46.67	124	9.56	16.00	42.76
1927	11,955,192.05	2,980,336.59	1,080,000.00	24.93	49.67	132	9.03	18.00	48.10
1928	13,967,351.40	3,506,743.91	1,200,000.00	25.11	58.45	156	8.59	20.00	53.45
1929	16,482,101.06	3,899,687.56	1,320,000.00	23.66	64.99	173	8.01	22.00	58.79
1930	19,810,829.98	4,372,013.70	1,440,000.00	22.07	72.87	194	7.27	24.00	64.14
1931	23,344,058.65	4,202,255.29	1,560,000.00	18.00	70.04	187	6.68	26.00	69.48
1932	25,951,080.26	4,100,602.51	1,680,000.00	15.80	68.34	182	6.47	28.00	74.82
1933	28,375,603.29	3,996,359.64	1,800,000.00	14.08	66.61	178	6.34	30.00	80.17
1934	30,557,743.97	3,637,784.07	2,280,000.00	11.90	60.63	162	7.46	38.00	101.55
1935	31,900,139.28	3,630,460.99	2,550,000.00	11.38	60.51	161	7.99	42.50	113.58
1936	33,235,529.37	4,093,619.98	3,600,000.00	12.32	68.23	182	10.83	60.00	160.35
1937	33,943,624.84	4,508,267.78	3,900,000.00	13.28	75.14	200	11.49	65.00	173.71
1938	34,520,977.37	3,710,454.28	3,900,000.00	10.75	61.84	165	11.30	65.00	173.71
1939	34,334,538.55	3,851,566.32	3,900,000.00	11.22	64.19	171	11.36	65.00	173.71
1940	34,288,544.67	3,575,306.01	3,540,000.00	10.43	59.59	159	10.32	59.00	157.68
1941	34,369,830.96	3,560,007.46	3,540,000.00	10.36	59.33	158	10.30	59.00	157.68
1942	35,914,645.60	3,551,074.81	3,105,000.00	9.89	47.35	94	8.65	[4] 41.40	[5] 82.91
1943	38,073,421.00	[6] 3,786,418.00	[7] 3,150,000.00	9.94	42.07	72.19	8.27	35.00	[5] 60.00
Total		70,361,189.02	45,345,000.00	[8] 16.58	[8] 59.99	[8] 156.06	[8] 8.96	[8] 38.31	[8] 99.16

[1] The figures in this column, except in 1943, are taken from Ex. 2, Sch. 1, col. 6, (R. 527). The 1943 figure is derived from the Sept. 30, 1943, figure (Ex. 27, Sch. 1, R. 586, and R. 35 and 38) with appropriate adjustments to Dec. 31, 1943.

[2] $6,300,000 from 1925 through June 1942 and $9,000,000 from July 1942 through Dec. 31, 1943. Figures in this column taken from R. 279.

[3] $2,245,000 from 1925 through June 1942 and $5,245,000 from July 1942 through Dec. 31, 1943. Figures in this column taken from R. 279.

[4] Based on an average of $7,500,000 par value for the year 1942.

[5] Based on an average investment of $3,745,000 for the year 1942.

[6] Ex. 73, R. 606.

[7] R. 486.

[8] Average.

TABLE II.—*Amount by which Pepco's surplus has been enhanced as a result of crediting depreciation reserve with interest at only 4 percent (as required by sliding scale arrangement) rather than interest at the allowed basic rate of return*

Year	Allowed basic rate of return	Interest on depreciation reserve		Annual deficiencies in interest credit (col. 3 minus col. 4)	Interest for the year, at allowed basic rate of return, on the sum of the deficiencies of prior years and interest thereon [1]	Annual amount by which surplus enhanced (col. 5+col. 6)
		Calculated at the allowed basic rate of return	Actually credited at 4 percent			
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1925	7.5%	$323,043.56	$172,289.90	$150,753.66	0	$150,753.66
1926	7.5%	376,870.71	200,997.71	175,873.00	$11,306.52	187,179.52
1927	7.5%	428,422.54	228,492.02	199,930.52	25,344.99	225,275.51
1928	7.5%	487,480.85	259,989.79	227,491.06	42,240.65	269,731.71
1929	7.5%	549,525.49	293,080.26	256,445.23	62,470.53	318,915.76
1930	7.5%	612,834.75	326,845.20	285,989.55	86,389.21	372,378.76
1931	7.0%	630,852.78	360,487.30	270,365.48	106,696.44	377,061.92
1932	7.0%	686,762.25	392,435.57	294,326.68	133,090.78	427,417.46
1933	7.0%	745,427.71	425,958.69	319,469.02	163,010.00	482,479.02
1934	7.0%	703,078.28	401,759.02	301,319.26	196,783.53	498,102.79
1935	6.5%	709,752.77	436,770.94	272,981.83	215,104.25	488,086.08
1936	6.5%	765,857.42	471,296.88	294,560.54	246,829.84	541,390.38
1937	6.0%	746,479.75	497,653.17	248,826.58	260,326.35	509,152.93
1938	6.0%	785,488.69	523,659.13	261,829.56	290,875.53	552,705.09
1939	6.0%	837,040.64	558,027.10	279,013.54	324,037.84	603,051.38
1940	6.0%	895,321.72	596,881.15	298,440.57	360,220.92	658,661.49
1941	6.0%	923,266.46	615,510.98	307,755.48	399,740.61	707,496.09
1942	6.0%	940,824.94	627,216.63	313,608.31	442,190.37	755,798.68
1943	6.0%	1,047,954.00	698,636.00	349,318.00	487,538.29	836,856.29
Total		13,196,285.31	8,087,987.44	5,108,297.87	3,854,196.65	8,962,494.52

[1] Calculated at the rate of interest in column 2 on the amount which is the total of the deficiencies of prior years shown in column 5 and the amount on the preceding line in column 6.

TABLE III.—*Amount by which Pepco's surplus has been enhanced as a result of crediting depreciation reserve with interest at only 4 percent (as required by sliding scale arrangement) rather than interest at the rate of return actually earned*

Year	Rate of return earned as computed by Commission	Interest on depreciation reserve		Annual deficiencies in interest credit (col. 3 minus col. 4)	Interest for the year, at the rate of return earned (col. 2), on the sum of the deficiencies of prior years and interest thereon [1]	Annual amount by which surplus enhanced (col. 5 plus col. 6)
		Calculated at rate of return actually earned	Actually credited at 4 percent			
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1925	9.59%	$413,065.03	$172,289.90	$240,775.13		$240,775.13
1926	9.72%	488,424.43	200,997.71	287,426.72	$23,403.34	310,830.06
1927	9.22%	526,674.10	228,492.02	298,182.08	50,858.00	349,040.08
1928	10.28%	668,173.76	259,989.79	408,183.97	92,586.33	500,770.30
1929	10.34%	757,612.47	293,080.26	464,532.21	144,906.37	609,438.58
1930	10.71%	875,128.02	326,845.20	548,383.82	215,362.48	763,645.30
1931	9.56%	861,564.64	360,487.30	501,077.34	265,242.15	766,319.49
1932	8.80%	863,358.25	392,435.57	470,922.68	311,592.07	782,514.75
1933	8.23%	876,410.00	425,958.69	450,451.31	355,810.36	806,261.67
1934	7.45%	748,276.17	401,759.02	346,517.15	382,154.85	728,672.00
1935	7.42%	810,210.09	436,770.94	373,439.15	434,683.44	808,122.59
1936	7.91%	931,989.58	471,296.88	460,692.70	527,311.45	988,004.15
1937	7.95%	989,085.67	497,653.17	491,432.50	608,524.33	1,099,956.83
1938	7.02%	919,021.77	523,659.13	395,362.64	614,555.44	1,009,918.08
1939	7.39%	1,030,955.06	558,027.10	472,927.96	721,579.48	1,194,507.44
1940	6.79%	1,013,205.75	596,881.15	416,324.60	744,100.92	1,160,425.52
1941	5.99%	921,727.69	615,510.98	306,216.71	725,940.20	1,032,156.91
1942	6.62%	1,038,043.52	627,216.63	410,826.89	870,619.95	1,281,446.84
1943	6.74%	1,177,201.66	698,636.00	478,565.66	972,771.10	1,451,336.76
Total		15,910,127.66	8,087,987.44	7,822,140.22	8,062,002.26	15,884,142.48

[1] Calculated at the rate of interest in col. 2 on the amount which is the total of the deficiencies of prior years shown in col. 5 and the amount on the preceding line in col. 6.

APPENDIX B

The pertinent provisions of the District of Columbia Utility Law, 37 Stat. 974, as amended by 49 Stat. 882, D. C. Code (1940) 43–101 *et seq.* follow:

> PAR. 2. That every public utility doing business within the District of Columbia is required to furnish service and facilities reasonably safe and adequate and in all respects just and reasonable. The charge made by any such public utility for any facility or services furnished or rendered, or to be furnished or rendered, shall be reasonable, just, and nondiscriminatory. Every unjust or unreasonable or discriminatory charge for such facility or service is prohibited and is hereby declared unlawful. Every public utility is hereby required to obey the lawful orders of the commission created by this section.
>
> * * * * *
>
> PAR. 16. That every public utility shall carry a proper and adequate depreciation account. The commission shall ascertain and determine what are the proper and adequate rates of depreciation of the several classes of property of each public utility. These rates shall be such as will provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry. Each public utility shall conform its depreciation accounts to such rates so ascertained and deter-

mined by the commission. The commission may make changes in such rates of depreciation from time to time as it may find to be necessary. The commission shall also prescribe rules, regulations, and forms of accounts regarding such depreciation which the public utility is required to carry into effect. The commission shall provide for such depreciation in fixing the rates, tolls, and charges to be paid by the public. All moneys in this fund may be expended in keeping the property of such public utility in repair and good and serviceable condition for the use to which it is devoted, or invested, and, if invested, the income from the investments shall also be carried in the depreciation fund. This fund and the proceeds thereof shall be used for no other purpose than as provided in this paragraph, unless with the consent and by order of the commission.

* * * * *

PAR. 18. That nothing in this section shall be taken to prohibit a public utility, with the consent of the commission, from providing a sliding scale of rates and dividends according to what is commonly known as the Boston sliding scale, or other financial device that may be practicable and advantageous to the parties interested. No such arrangement or device shall be lawful until it shall be found by the commission, after investigation, to be reasonable and just and not inconsistent with the purposes of this section. Such arrangement shall be under the supervision and regulation of the commission. The commission shall ascertain, determine, and order such rates, charges, and regulations, and the duration thereof, as may be necessary to give effect

to such arrangement, but the right and power to make such other and further changes in rates, charges, and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to alter or amend all orders relative thereto, is reserved and vested in the commission notwithstanding any such arrangement and mutual agreement.

* * * * *

PAR. 24. That every public utility shall file with the commission, within a time to be fixed by the commission, schedules, which shall be open to public inspection, showing all rates, tolls, and charges which it has established and which are in force at the time for any service performed by it within the District of Columbia, or for any service in connection therewith or performed by any public utility controlled or operated by it. The rates, tolls, and charges shown on such schedules shall not exceed the rates, tolls, and charges now allowed by law, and shall be the lawful rates, tolls and charges within the District of Columbia, and shall remain and be in force until set aside by the commission.

* * * * *

PAR. 30. That it shall be unlawful for any public utility to charge, demand, collect, or receive a greater or less compensation for any service performed by it within the District of Columbia, or for any service in connection therewith, than is specified in such printed schedules, including schedules of joint rates, as may at the time be in force, or to demand, collect, or receive any rate, toll, or charge not specified in such schedules. The rates, tolls, and charges named therein shall be the lawful rates,

tolls, and charges until the same are changed as provided in this section.

* * * * *

PAR. 64. * * * That any public utility or any other person or corporation affected by any final order or decision of the Commission may, within thirty days after the publication thereof, file with the Commission an application in writing requesting a reconsideration of the matters involved, and stating specifically the errors claimed as grounds for such reconsideration. No public utility, or other person or corporation shall in any court urge or rely on any ground not so set forth in said application. The Commission, within thirty days after the filing of such application, shall either grant or deny it. Failure by the Commission to act upon such application within such period shall be deemed a denial thereof. If such application be granted, the Commission, after giving notice thereof to all interested parties, shall, either with or without hearing, rescind, modify, or affirm its order or decision. The filing of such an application shall act as a stay upon the execution of the order or decision of the Commission until the final action of the Commission upon the application: *Provided,* That upon written consent of the utility such order or decision shall not be stayed unless otherwise ordered by the Commission. No appeal shall lie from any order of the Commission unless an application for reconsideration shall have been first made and determined.

* * * * *

PAR. 65. The District Court of the United States for the District of Columbia shall have jurisdiction to hear and determine

any appeal from an order or decision of the Commission. Any public utility, or any other person or corporation affected by any final order or decision of the Commission, other than an order fixing or determining the value of the property of a public utility in a proceeding solely for that purpose, may within sixty days after final action by the Commission upon the petition for reconsideration, file with the clerk of the District Court of the United States for the District of Columbia, a petition of appeal setting forth the reasons for such appeal and the relief sought; at the same time such appellant shall file with the Commission notice in writing of the appeal together with a copy of the petition. Within twenty days of the receipt of such notice of appeal the Commission shall file with the clerk of the said court the record, including a transcript of all proceedings had and testimony taken before the Commission, duly certified, upon which the said order or decision of the Commission was based, together with a statement of its findings of fact and conclusions upon the said record, and a copy of the application for reconsideration, and the orders entered thereon: *Provided,* That the parties, with the consent and approval of the Commission, may stipulate in writing that only certain portions of the record be transcribed and transmitted. Within this period the Commission or any other interested party shall answer, demur, or otherwise move or plead. Thereupon the appeal shall be at issue and ready for hearing. All such proceedings shall have precedence over any civil cause of a different nature pending in said court, and the District Court of the United States for the District of Columbia shall always be

deemed open for the hearing thereof. Any such appeal shall be heard upon the record before the Commission, and no new or additional evidence shall be received by the said court. The said court, or any justice or justices thereof, before whom any such appeal shall be heard, may require and direct the Commission to receive additional evidence upon any subject related to the issues on said appeal concerning which evidence was improperly excluded in the hearing before the Commission or upon which the record may contain no substantial evidence. Upon receipt of such requirement and direction the Commission shall receive such evidence and without unreasonable delay shall transmit to the said court the findings of fact made thereon by the Commission and the conclusions of the Commission upon the said facts.

Upon the conclusion of its hearing of any such appeal the court shall either dismiss the said appeal and affirm the order or decision of the Commission or sustain the appeal and vacate the Commission's order or decision. In either event the court shall accompany its order by a statement of its reasons for its action, and in the case of the vacation of an order or decision of the Commission the statement shall relate the particulars in and the extent to which such order or decision was defective.

Any party, including said Commission, may appeal from the order or decree of said court to the Court of Appeals of the District of Columbia, which shall thereupon have and take jurisdiction in every such appeal. Thereafter the Supreme Court of the United States may, upon a petition for certiorari granted in its discretion, review the said case.

Said Commission shall not, nor shall any of its members, officers, agents, or employees, be taxed with any costs, nor shall they or any of them be required to give any supersedeas bond or security for costs or damages on any appeal whatsoever. Said Commission, or any of its members, officers, agents, or employees, shall not be liable to suit or action or for any judgment or decree for any damages, loss, or injury claimed by any public utility or person, nor required in any case to make any deposit for costs or pay for any service to the clerks of any court or to the marshal of the United States.

PAR. 66. In the determination of any appeal from an order or decision of the Commission the review by the court shall be limited to questions of law, including constitutional questions; and the findings of fact by the Commission shall be conclusive unless it shall appear that such findings of the Commission are unreasonable, arbitrary or capricious.

* * * * *

PAR. 75. That no public utility shall declare any stock, bond, or scrip dividend or divide the proceeds of the sale of any stock, bond, or scrip among its stockholders.

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No. 1135

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1946

THE UNITED STATES, *Petitioner,*

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL., *Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF IN OPPOSITION

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DIVISION OF PRINTING AND PUBLICATIONS—GOVERNMENT OF THE DISTRICT OF COLUMBIA

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Par. 66, Sec. 8, of the Act of March 4, 1913, 37 Stat. 989, ch. 150, as amended by Sec. 2 of the Act of August 27, 1935, 49 Stat. 883, ch. 742 (Sec. 43-706, D. C. Code, 1940)	4

Constitution of the United States

Article I, Section 8, Clause 17	2
Fifth Amendment	1

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1946
No. 1135

THE UNITED STATES, *Petitioner,*

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL., *Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF IN OPPOSITION

SUMMARY OF ARGUMENT

This case does not present any of the questions upon which this Court ordinarily grants a writ of certiorari. No contention is made that the rate order of the Public Utilities Commission is in violation of the due process clause of the Fifth Amendment.

The Commission in establishing the rate order did not neglect the interests of the consumer but on the contrary adequately protected the consumer by reducing the rate and ordering a refund.

The Potomac Electric Power Company, the utility company here involved, is entitled to a return on its earned surplus since the surplus is not a contribution by the consumer.

The findings of fact of the Commission are not unreasonable, arbitrary or capricious; therefore, they are conclusive.

The Commission is presumed to have acted in accordance with law.

The petition constitutes nothing more than a request for another hearing.

ARGUMENT

I

The petition should be denied

The statute involved is limited in its operation to the District of Columbia. This Court has stated that it will not ordinarily review decisions of the United States Court of Appeals for the District of Columbia which are based upon statutes limited in their operation to the District of Columbia. *District of Columbia* v. *Pace,* 320 U. S. 698, 702, 64 S. Ct. 406, 88 L. Ed. 408; *Del Vecchio* v. *Bowers,* 296 U. S. 280, 285, 56 S. Ct. 190, 80 L. Ed. 229.

The case does not involve a question of general importance or a question of substance relating to the construction or application of the Constitution, or a treaty of the United States, which has not been, but should be, settled by this Court. The petitioner does not question the constitutionality of the statute. The case does not involve a statute of the United States which should be settled by this Court although the statute involved was enacted by the Congress of the United States. All statutes in force and effect in the District of Columbia are enacted by Congress in the exercise of that power expressly delegated to it by Article I, Section 8, Clause 17, of the Constitution. Subject only to those prohibitions of the Constitution which act directly or by implication upon the federal government, Congress possesses full and unlimited jurisdiction to provide for the general welfare of citizens within

the District of Columbia by any and every act of legislation which it may deem conducive to that end. When acting thus, Congress acts as a legislature of national character. *Cohens* v. *Virginia*, 19 U. S. 264, 6 Wheat. 264, 5 L. Ed. 257. However that may be, the statute is not national in its operation.

II

The Commission adequately protected the consumer by reducing the rate and ordering a refund

That the Commission in establishing the rate order did not neglect the interests of the consumer but adequately protected the consumer is borne out by the following excerpts from the decision of the United States Court of Appeals for the District of Columbia in the instant case:

> "It is urged that the entire arrangement of the sliding scale for the period in which it has been in operation permitted the Company to earn an exorbitant, and 'unlawful' profit at the expense of the consumers. In the first place we note that as a practical matter the arrangement did result in a steady and substantial reduction in the cost of electric power. The permissible rate of return to the Company was reduced over a period of years in accordance with the general decline of interest rates and each year one-half of the excess earnings were set up as the basis for reducing consumer's price schedules." (R. 659)
>
> " * * * In the instant case it appears that the power consumers in this locality enjoy rate schedules that compare very favorably with those prevailing in other major cities. This, of course, is not an argument to show that the rates should not be still lower, but it does go to establish that high profits and just rates are not prima facie incompatible.
>
> " * * * we do not think that this court should impose its judgment to the effect that these earnings be declared 'unlawful', unless it clearly be shown that

> the rates which gave rise to the earnings are invalid because they woefully neglected the interests of the consumers." (R. 660-661)

In the light of these premises the order of the Commission should be sustained.

III

The Company is entitled to a return on its earned surplus since the earned surplus is not a contribution by the consumer

This Court has held that even though in prior years a company charged excessive amounts to depreciation expense and so created in the reserve account balances greater than required adequately to maintain the property, the revenue paid by the customer for service belongs to the company and the amount remaining after paying taxes and operating expenses is the company's compensation for the use of its property. Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stocks. *Board of Public Utility Commissioners* v. *New York Telephone Co.*, 271 U. S. 23, 46 S. Ct. 363, 70 L. Ed. 808. It follows, therefore, that instead of investing this reserve in plant the Company could have disbursed it in dividends. The Company chose to invest this surplus in its plant used and useful in supplying electric power to its customers, and the value of the plant should be included in the rate base.

IV

Since the findings of fact of the Commission are not unreasonable, arbitrary or capricious, they are conclusive

Paragraph 66, Section 8, of the Act of March 4, 1913, 37 Stat. 989, ch. 150, as amended by Section 2 of the Act of August 27, 1935, 49 Stat. 883, ch. 742 (Section 43-706, D. C. Code, 1940), (Petition, page 36), provides that:

> "In the determination of any appeal from an order or decision of the commission the review by the court shall be limited to questions of law, including constitutional questions; and the findings of fact by the commission shall be conclusive unless it shall appear that such findings of the commission are unreasonable, arbitrary or capricious."

In its essentials, the order complained of constitutes the finding of an ultimate fact. It is submitted that the order has warrant in the record and a reasonable basis in the law. *Cf. Dobson* v. *Commissioner,* 320 U. S. 489, 64 S. Ct. 239, 88 L. Ed. 248.

V

The Commission is presumed to have acted in accordance with law

This Court has said that "It is well established that in a question of rate-making there is a strong presumption in favor of the conclusions reached by an experienced administrative body after a full hearing." *Darnell* v. *Edwards,* 244 U. S. 564, 569, 37 S. Ct. 701, 61 L. Ed. 1317, 1321.

It is to be presumed that public officers act rightly. *Pendleton County* v. *Amy,* 80 U. S. 297, 13 Wall. 297, 20 L. Ed. 579; *Town of Coloma* v. *Eaves,* 92 U. S. 484, 2 Otto 484, 23 L. Ed. 579; *Quinlan* v. *Green County,* 205 U. S. 410, 27 S. Ct. 505, 51 L. Ed. 860.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1946

UNITED STATES OF AMERICA,
Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, *et al.*,
Respondents.

Memorandum for Potomac Electric Power Company, Respondent, in Opposition to Petition for Certiorari

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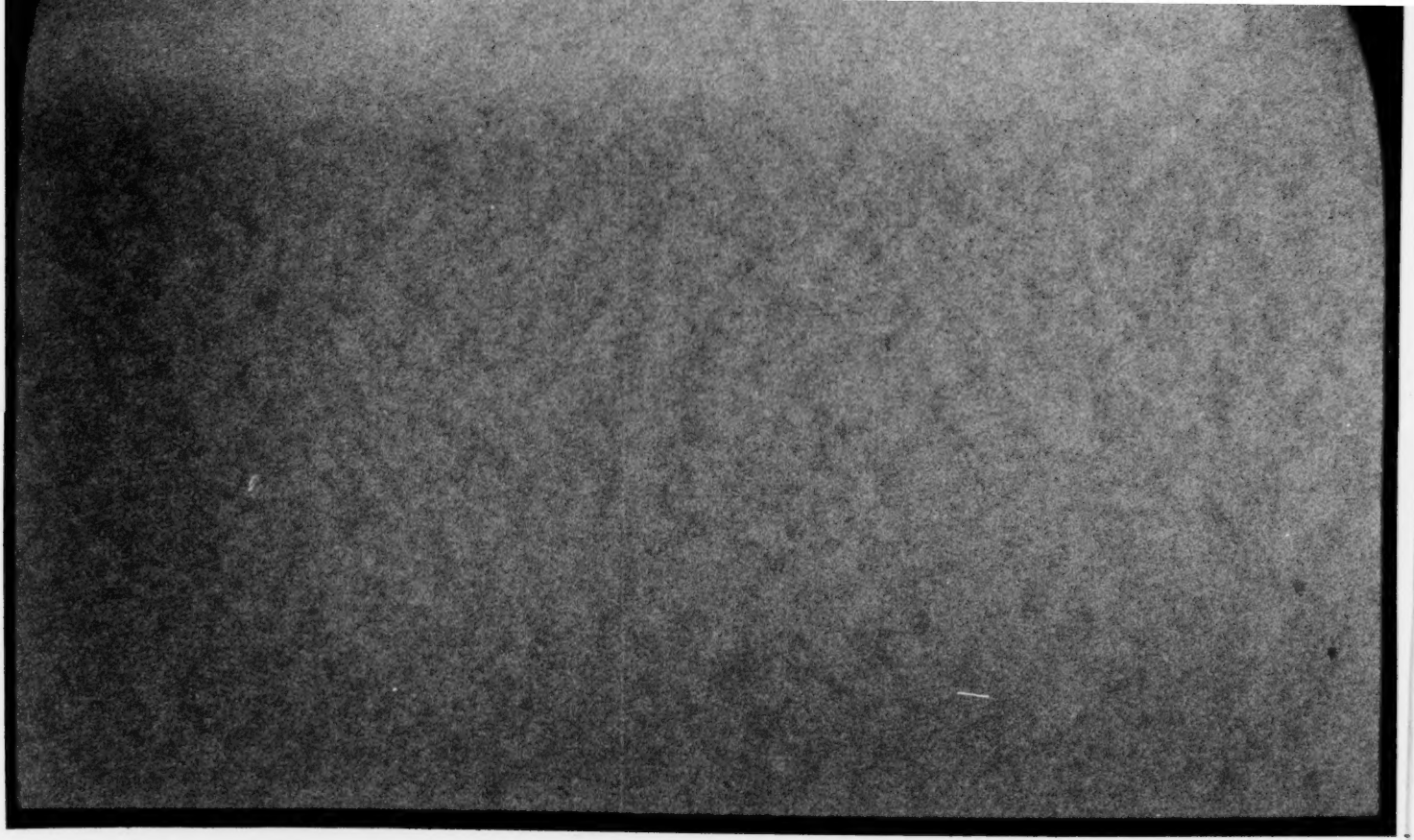
Dated April 14, 1947.



Memorandum for Potomac Electric Power Company, Respondent, in Opposition to Petition for Certiorari

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Unlike the company's petition in No. 1038, which puts the question of power, the petition of the United States in No. 1135 is addressed to a matter of administrative discretion. Though both relate to the same order of the Commission, the company's would explore the boundaries of Commission power on a point of general interest, while the Government's would question the manner in which an assumed power should be exercised in this particular case.

The Commission undoubtedly gave great weight to the mathematical analysis stated in its opinion. But it took a broader view of its responsibilities. They were not merely to trace an equation on paper, but to balance the interests of consumer and investor so as to reach a practical result in the public interest. This was, of course, a factual inquiry. The nature and size of the company, the results of its operations and its prospects for the future were all pertinent. Low rates were desirable, but so also was the preservation of the company's ability to maintain and improve its service. Whatever the Commission's failure to follow statutory requirements urged by the company in No. 1038, clearly its final conclusion was a judgment act that purported to synthesize all these practical factors.

In broad perspective this step of the Commission may be viewed as an acceleration of its program, already enforced for many years, of progressive rate reductions, by which rates had been reduced substantially below the national average (R. 6; Petition, p. 6). The Commission acted, however, with realization of "the adverse effect of abrupt or violent changes in the return" (R. 31). The wisdom of one step at a time in the application of that policy is all the

clearer now when the whirlwind of ascendant costs is forcing so many public service companies, already exemplified by the rails and the communication companies, to seek large increases in their rates.

The Government's petition is not addressed to these functional elements, but looks wholly to technique, as if the manifold pragmatic adjustments of a rate order could be stated in a syllogism. Even at that level, however, it is clear that what the Government really attacks is the permitted return. But that is the product of the rate base and the rate of return. Any reduction in the rate base may be offset by a corresponding increase in the rate of return, for it is only their product that matters. Yet the rate of return is a point on which the Commission must be allowed a particularly wide area of discretion. It could not be said to have erred as a matter of law if it had in terms approved a rate of return high enough to permit more than the full amount of the actual earnings. In point of fact, the approval given by its annual rate orders contemplated and permitted the earnings actually realized, and none the less so because they happened to exceed the postulated norm toward which the orders successively approached. The actual earnings were, therefore, lawful earnings. So facilities acquired with them were, as the petition in that event admits (p. 16, n. 13), property on which, as much as any other, the company was entitled to earn a return (*Board of Public Utility Commissioners* v. *New York Telephone Co.*, 271 U.S. 23, 31, 1926).

The contrary could be urged only by asserting that all rates in the past were unlawfully high, though fixed by annual orders of the designated authority, each of which became final under the terms of local law. It may well be doubted whether such an assertion is of a sort to merit consideration by this Court. Not only does it collide with the legislative scheme for rate regulation, but further, it

undoes the work of government itself. And, for the future, it would undermine the administrative process by substituting for judgment a set of rules that could only "create an illusion of certainty where none exists" (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R.*, 318 U. S. 523, 565, 1943). The law on that point has been too recently proclaimed to need further exposition by this Court now (*Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, 1944; *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 1942).

So we submit that the Government's petition in No. 1135 should be denied. But were the Court to review those contentions on the method for the exercise of administrative discretion, then *a fortiori* the writ should be granted in No. 1038, which challenges the power on which any such discretion must rest.

Dated April 14, 1947.

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October Term, 1946

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PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL., *Respondents.*

BRIEF OF RESPONDENT, PUBLIC UTILITIES COMMISSION, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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DIVISION OF PRINTING AND PUBLICATIONS—GOVERNMENT OF THE DISTRICT OF COLUMBIA

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COUNTER STATEMENT

The Public Utilities Commission of the District of Columbia (Commission) instituted an investigation to determine whether the sliding-scale arrangement should be abandoned or modified, and if to be modified in what particulars. This investigation was consolidated with the annual rate investigation under the plan for the year 1943.

The Public Buildings Administration of the Federal Works Agency and the Procurement Division of the Treasury Department intervened in the proceedings before the Commission, both in the name of the United States. Both agencies took contrary positions on all issues involved. The Public Buildings Administration contended that pursuant to a design and conspiracy, the sliding-scale arrangement was adopted as a device by which excessive, unlawful and unreasonable rates were to be extracted from consumers (R. 505, 507), and urged that the arrangement be abandoned. The Procurement Division urged that the principles of the sliding-scale plan be preserved but that it be modified in certain particulars (R. 10).

The only witness called by the Public Buildings Administration was Charles W. Smith, Chief of the Bureau of Accounts, Finances and Rates of the Federal Power Commission, who testified that he envied the sliding-scale arrangement because it has benefits to the public as compared to the typical fair-value procedure (R. 396). He pointed out the benefits of the plan (R. 378, 379, 398). Professor James C. Bonbright of New York City, Economist, Professor of Finance of the Business School in Columbia University and specialist in public utility matters, was called as a witness by the Procurement Division and recommended certain modifications of the sliding-scale arrangement. He testified "that the sliding-scale plan deserves substantial credit, both for the promptness and for the amount of the reductions in residential rates" (R. 408).

The sliding-scale plan was adopted in a Consent Decree of the Supreme Court of the District of Columbia (now the District Court) on December 31, 1924 (R. 57-62), after seven years of litigation (R. 3). The Court found the plan was "fair and reasonable" (R. 60). Paragraph 18 of the Act (37 Stat. 980) provides that no sliding-scale arrangement shall be lawful until it shall be found by the Commission "after investi-

gation, to be reasonable and just and not inconsistent with the purposes" of the Act.

In the court below the Petitioner argued that the sliding-scale plan was illegal from its inception and has resulted in the extraction from the consumers of illegal and unlawful rates. It said the arrangement was "unlawful in its inception, and has always been unlawful in its administration" (R. 660, Note 27). The lower court said "The foundation upon which all the argument of the United States rests is its contention that, throughout the many years during which the sliding scale arrangement has been in effect, the rates have been excessive and illegal" (R. 662).

Under the arrangement, rates have been reduced each year since the plan was adopted except for the year 1942 when no rate adjustment was required (R. 6). While the company has earned, from 1925 to 1942, $16,130,385.49 above the basic rate of return used as a measure for rate adjustments, the consumers have, during the same period, had cumulative savings of more than $86,000,000 without giving consideration to the additional savings applicable to increased consumption in each of the years (R. 8).

Two different People's Counsel, appointed by the President and confirmed by the Senate, speaking for the consumers, have opposed the contentions made by the Petitioner in the instant proceeding.[1]

The Petitioner contended in the courts below and contends here, that the sliding-scale arrangement was illegal in its inception and was illegally applied, and that rates in effect since 1925 have been illegal and unlawful. Based upon this erroneous conclusion the Petitioner says the surplus and part of the depreciation reserve of the Potomac Electric Power Company (Company or Pepco) are illegal and that the Com-

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[1] When there was no People's Counsel to speak for the consumers, the Federation of Citizens Association intervened in the District Court and filed a brief as *amicus curiae* in this Court in opposition to the same general contentions raised by the same Petitioner in another proceeding. *Vinson* v. *Washington Gas Light Co.*, 321 U. S. 489.

mission should "recapture" (Pages 6, 18, Note 15) for the consumers, all of the company's assets which have been acquired from undistributed earnings. The Petitioner contended below that $29,000,000 should be excluded from the rate base for this reason (R. 659). It seeks to recapture from the company approximately 36% of the actual cost of the property devoted to public service. It seeks a rate base representing approximately 64% of the actual original cost of the property used in the public service. Neither the statute nor the sliding-scale plan authorizes the Commission to "recapture" any part of a utility's property. Paragraph 7 of the Act (37 Stat. 978) requires the Commission to value the property of every public utility "actually used and useful for the convenience of the public at the fair value thereof at the time of said valuation".

Both the Public Buildings Administration and the Procurement Division filed applications for reconsideration of the Commission's Order No. 2796. The Procurement Division contended before the Commission that the company's rate base as of December 31, 1943, "did not exceed $67,000,000" (R. 15 and 228). The Public Buildings Administration called as its only witness Charles W. Smith, Chief of the Bureau of Accounts, Finance and Rates of the Federal Power Commission, who testified that the prudent investment rate base was $82,749,207 (R. 423, 604). In disregard of this evidence of its witness, the Public Buildings Administration contended the rate base should not exceed $53,459,000 (R. 16).

In its application for reconsideration, the Procurement Division contended that the rate reduction should be "not less than $3,000,000" (R. 227). The Public Buildings Administration contended that the rate reduction should be "at least $3,860,000 (R. 235). But its witness testified that the excess over the return was $2,030,530 (R. 605), which on the sliding-scale principle would allow a rate reduction of only $1,015,265. The Commission fixed the rate reduction in the amount of $1,037,189 (R. 43, 45).

Witness Charles W. Smith for the Public Buildings Administration, testified that the reserve for depreciation to be deducted from original cost of property was $17,782,057 (R. 423, 604). In disregard of this testimony, the Public Buildings Administration contended the accrued depreciation to be deducted from the original cost of property was $17,071,000 (R. 16). Mr. Smith testified that the book reserve for depreciation was the proper amount to be used in establishing a rate base (R. 368, 369, 395, 397). In its application for reconsideration, the Public Buildings Administration contended that the Commission "erred in accepting a book depreciation reserve" (R. 234).

The Procurement Division contended in its application for reconsideration, that the Commission erred in failing to find the depreciation reserve to be $21,600,000 (R. 228). In the complaint in the District Court, the Petitioner alleged that $14,000,000 should "be added to the depreciation reserve and so included in the amount to be deducted from the gross rate base" (R. 52).

When the Petitioner filed its complaint below on behalf of the two Federal agencies, it did not allege what amount the rate base should be nor what the depreciation reserve to be deducted from original cost should be, nor by what amount the rates should be reduced (R. 47-56).

Both here and below, the Petitioner contended that the entire surplus be excluded from the rate base (R. 15, 16, 659, 661). The only witness presented by the Petitioner on the subject of the value of the property, testified that the rate base should consist of the original cost of the property used less the book reserve for depreciation (R. 422, 423, 604). The witness included in his Exhibit No. 45, reproduced on Record page 604, all of the property acquired from undistributed earnings. The Petitioner also contended that the entire surplus should be excluded from the statement of the invested capital (R. 16, 55, 232). Arthur E. Lundvall, Chief Accountant for the Federal Trade Commission, was presented as a witness

for the Procurement Division (R. 334), and testified that the original investment and undistributed earnings invested in assets constituted the invested capital and was part of the common stock equity (R. 390-392). Professor Bonbright, another witness for the Procurement Division, testified that earnings should be calculated on the common stock equity (R. 412).

The original sliding-scale arrangement provided for a rate base as of January 1, 1925, of $32,500,000 and a depreciation reserve as of December 31, 1924, of approximately $4,000,000. It provided that the rates for the year 1925 were to be based upon a return of 7½% on the value so stated plus estimated cost of additions undepreciated and weighted. The plan provided that on the depreciation reserve "interest will be accrued on a 4 percent basis and as an accretion to the reserve, lessening the amount of depreciation to be included as an expense of operation" (R. 58). Under the sliding-scale plan, all additions to property have been included in the rate base, weighted, at the actual cost of the property, so that as existing property was retired the rate base would become the actual cost of the property. The rate base established under the plan before it was modified by Order No. 2796 was approximately 95 percent original cost (R. 19). Thus, the rate of return of 6 percent prior to the reduction in the rate of return in Order No. 2796 was applied to a weighted rate base approximating 95 percent of the actual cost of the property used.

The original plan provided that "if the rates hereafter yield more than a 7½ percent return" on the rate base "during a period of any one year, one-half of said excess shall be used in a reduction of rates to be charged the public for electric service thereafter" thereby providing a sliding-scale of rates "advantageous to the public and company alike; that is to say, by way of example, if the return for any one year should amount to $100,000 over and above 7½ percent on the base ascertained as aforesaid then the rates for the succeeding year to be charged the public shall be automatically reduced by the

filing of new rate schedules to absorb $50,000 of such excess during such year" (R. 58-59).

The plan also provided for rate increases "If the average return for any consecutive 5-year period" falls below 7½ percent, or if the average return "for any consecutive 3-year period" falls below 7 per cent, or if the average return "for any consecutive 12-month period" falls below 6½ per cent on the rate base (R. 59).

The basic rate of return was reduced by the Commission in 1931, 1935, and 1937, and upon each modification the percentage steps for rate adjustments, up or down, were likewise modified to conform to the new basic rate of return (R. 4).

During the period 1925 to 1930 inclusive "when the basic rate of return allowed was 7½%, the average rate of return actually earned over this period was 10.03% per annum; during the years 1931 to 1934, inclusive, during which period the basic rate of return allowed was 7%, the actual average rate of return was 8.46%; during the 2 years 1935 and 1936, when the basic rate of return was 6½%, the actual return was 7.42% and 7.91% for each of these respective years (R. 7). From 1937 to 1942, inclusive, during which period the basic rate of return established was 6%, the actual return earned ranged from 7.95%, down to 5.99% or an average of 6.91%" (R. 7). During the period from 1937 through 1943 when the basic rate of return was 6% "the actual return, on the average, was but .91 of 1% in excess thereof" (R. 7).

In 1924, before the sliding-scale plan was adopted, the cost of 100 kwh consumption for residential service in the District of Columbia was $9.24, as compared with an average cost of $6.18 in 150 cities having a population of 50,000 or more (R. 5, Table between R. 566 and 567). For the year 1942, the cost for 100 kwh for residential service in the District of Columbia was $2.56, as compared with an average cost of $3.80 for all cities having a population of 50,000 or more (R. 6).

In the first year of the operation of the sliding-scale plan the cost of 100 kwh was reduced from $9.24 to $7.02. Since 1930 the cost of 100 kwh for residential service in the District of Columbia has steadily declined below the cost of cities having 50,000 or more population (Table between R. 566 and 567). The billing cost of 100 kwh for residential consumption in the District of Columbia has declined to 27.7 per cent of the 1924 cost while the average cost of seven comparable electric utilities has declined to 69.5 per cent of the 1924 cost (R. 566).

In 1924, before the sliding-scale was adopted, the monthly bills for 25 kwh for residential consumption in the District of Columbia was $2.50, while the average cost of 25 kwh for residential consumption of seven comparable electric utilities was $1.93. In 1942, the billing cost of 25 kwh for residential consumption in the District of Columbia had declined to $0.98, while the average for the same seven comparable electric utilities was $1.38. The cost of 25 kwh for residential consumption in the District of Columbia has steadily declined below the billing cost in the seven companies so that the cost in 1942 was 39.2% of the 1924 cost, while the average cost of the same seven companies was 71.5% of the 1924 cost (R. 564).

Before the sliding-scale was adopted the billing cost of 40 kwh for residential consumption in the District of Columbia was $4.00, while the average cost of seven comparable electric utilities was $2.87. From the first year of the operation of the sliding-scale plan, the cost for 40 kwh for residential consumption in the District of Columbia has steadily declined. In 1942 the cost of 40 kwh for residential consumption in the District of Columbia was $1.48, while the average cost for the same seven comparable companies was $2.04. The cost of 40 kwh in the District of Columbia has declined to 37% of the 1924 cost, while that for the seven comparable companies has declined to only 71.1% of the 1924 cost (R. 565).

The Petitioner argues that Pepco's depreciation reserve is excessive and constitutes, in part, unjust contributions by con-

sumers. In 1942 the depreciation deduction of Pepco was 10.3% of its revenue, while the average depreciation deduction of ten comparable electric utilities was 10.6% of their revenue (R. 557). Pepco's charge for depreciation in 1942 was 2.2% of its electric plant, while the average of the same ten comparable companies was 2.6% of their electric plant (R. 557). On December 31, 1942, the ratio of Pepco's depreciation reserve to the cost of its electric plant was 17.29% while the average ratio of ten comparable electric utilities was 17.84% (R. 560). The reserve for depreciation of the electric plant of Pepco December 31, 1942, was $16,667,162, while the average depreciation reserve for electric plant of the ten comparable companies was $17,511,135 (R. 560). Pepco's investment in electric plant on that date was $96,421,616, while the average investment in electric plant of the ten companies was $98,148,320 (R. 560).

The Petitioner argues that the Commission should deduct from Pepco's common stock equity $29,000,000 because, as it alleges, the surplus was built up by unlawful and illegal rates. The total common stock equity of Pepco, December 31, 1942, was $37,841,987 while the average common stock equity of ten comparable electric utilities was $40,381,008 (R. 560).

The capitalization ratios of Pepco, December 31, 1942, were 47.15% for long-term debt, 8.25% for preferred stock, and 44.60% for common stock equity, while the average of the ten comparable electric utilities were 47.39% for long-term debt, 13.54% for preferred stock, and 39.07% for common stock equity (R. 561).

The rate base established by the Commission in Order No. 2796 is the original cost of the property, less the depreciation reserve (R. 19, 21). The Commission found that the original cost of the electric plant on December 31, 1943, weighted, amounted to $98,633,399.89 (R. 19, 21). After deducting contributions in aid of construction and deposits for extension, and adding materials and supplies, the Commission found the gross rate base on December 31, 1943, weighted, to be $98,615,-

839.52 (R. 21, 42). From the weighted gross rate base, the Commission deducted the depreciation reserve adjusted and weighted for the year 1943 in the amount of $17,844,120.81 and found a weighted depreciated original cost rate base for the year 1943 of $80,771,719.04 (R. 42). It was upon this rate base that the Commission applied the new basic rate of return of 5½% to determine the amount of the rate reduction (R. 42-43). Giving effect to the rate reduction of $1,037,-189, and to the estimated savings in Federal income and excess profits taxes, the Commission found the company's pro forma net income for the year 1943 would amount to $3,645,093.89. After providing for preferred stock dividends it would leave $3,250,058.78 to provide a return of 8.91% on the company's common stock equity at December 31, 1943. The rate of return stated on page 10 of the Petition is the rate of return only for the year 1943.

The various statements in the Petition that the basic rate provided in the sliding-scale arrangement is the "established rate" are not correct. The sliding-scale plan permits the company to earn more or less than the *basic* rate which is used as a measure to determine rate adjustments (R. 40, 58, 59, 372). The rate of return referred to on page 9 of the Petition is "the allowed return" under the provisions of the sliding-scale arrangement and is the return only for the year 1943. The Commission's finding points out "that the return at the basic rate of 5½% of the rate base is not the actual return allowed the Company before any reduction is made in rates for the ensuing rate year, but is that amount plus a portion of the earnings in excess of such return. During the year under consideration, the allowed return is therefore 5.82%" (R. 40). This is what the lower court called the "permissible rate of return" (R. 659).

On page 5 of the Petition, it is said the sliding-scale arrangement originally provided that the rates were to yield 7½% return. The original sliding-scale plan (R. 58-59) did not provide that the rates were "to yield" a rate of return of

7½%. That rate was the *basic* rate of return to be used in adjustment of rates. The plan provided that additions to property should be included in the rate base at the actual cost (R. 58), so that as property was retired the rate base approached original cost of property. In 1943, the rate base under the sliding-scale plan before it was amended approximated 95% original cost of property (R. 18-19). The Commission reduced the basic rate of return to 5½% which was applied to the depreciated original cost of property, weighted for the year 1943 (R. 38, 42).

On page 7 of the Petition the Petitioner says that under its construction of the sliding-scale arrangement the Commission "in adjusting rates for each year, has sought to fix rates which would yield the established return plus one-half of the excess of the past year." This statement is misleading. The plan itself provided the formula for adjustment of rates. That formula has been strictly followed by the Commission in every rate adjustment (R. 41). The actual rate reductions made each year under the plan is set out on Record page 6. The net amount available for return in each of the years is shown on Record page 8, and shows the actual rate of return allowed by the plan as well as the basic rate of return used for the purpose of making rate adjustments. The basic rate of return applied to the net amount available for return shows that the actual rate reductions made are in exact accordance with the sliding-scale arrangement (R. 6, 8).

The application for reconsideration filed by the Public Buildings Administration contended that the Commission erred in failing to cause the cancellation of watered stock of Pepco (R. 233), and that the Commission erred in failing to exclude such watered stock from the invested capital in the cost-of-capital computation of the rate of return (R. 233). The Commission's findings show that no part of the so-called "watered stock" was included in the statement of the common stock equity (R. 16). At the time of the reclassification of the fixed capital accounts of Pepco, in accordance with orders

issued by the Federal Power Commission and by the Public Utilities Commission, "all differences between original cost and the book cost of property were eliminated from the plant account of Pepco, with corresponding charges against earned surplus and other appropriate accounts. Thus, no inflationary or improper amounts are reflected in the equity capital as presently constituted and used in this study of cost of invested capital" (R. 35, 36).

SUMMARY OF ARGUMENT

1. The Commission found as a matter of fact that the company's surplus or undistributed earnings was invested in assets used in public service. It found as a fact that this investment constitued part of the invested capital and that property representing such investment was a part of the rate base. The Courts have universally held that funds invested, from whatever source, are part of "invested capital" and that property acquired from undistributed earnings or depreciation reserve is as much a part of the rate base as property acquired from proceeds from the sale of securities.

The Petitioner's contention that surplus invested in used assets should be excluded from the rate base and from a statement of invested capital is contrary to the testimony of its own witnesses and all other evidence of record. The contention is based upon argument without support that rates in effect since January 1, 1925, have been illegal. The exclusion from the rate base of all property acquired from undistributed earnings would be a clear violation of the statute and of the Constitution.

2. The contention that the sliding-scale resulted from a conspiracy to establish a device to extract from consumers unlawful and unreasonable rates is disproved by the record of the rate reductions. The statement is contrary to testimony of witnesses called by the Petitioner. It is contrary to the belief expressed by consumers.

3. The decision below is not in conflict with the decisions of this Court nor with that of any Circuit Court of Appeals. It is in accord with principles announced by this and other courts. This Court has reviewed the statute involved and held contrary to one of the positions taken by the Petitioner. This Court has approved a sliding-scale arrangement adopted under the statute involved. No valid reason has been advanced in the Petition for granting a writ of certiorari.

ARGUMENT

I

Undistributed Earnings Invested in Used Assets Constitute Invested Capital, and Property So Acquired Is Part of the Rate Base.

On page 13 of the petition, the Petitioner says that the Commission acted, and the court below affirmed that action, on the erroneous assumption that "as a matter of law, exclusion of the surplus could not be sustained." On page 15 it said the Commission and the court below held that the Commision is "without power to exclude from the rate base and the common stock equity" the company's surplus. Neither the Commission nor the court decided that question on the narrow ground stated by the Petitioner. The Commission found upon undisputed evidence that the surplus referred to was invested in property used in the public service and that such property constituted property of the company as much as property acquired from any other source of funds. There is no testimony in the record that property acquired from undistributed earnings or surplus is not used in the public service. There is no testimony in the record that the surplus is illegal and unlawful. The Petitioner's contention is based upon argument that is contrary to the evidence. The lower court said:

> "The foundation upon which all the argument of the United States rests is its contention that, throughout the many years during which the sliding scale arrangement has been in effect, the rates have been excessive and illegal" (R. 662).

The Commission said the elimination of earned surplus or undistributed earnings from invested capital "finds no support in reason or in law" (R. 15). It said that it is universally recognized by both courts and regulatory authorities that undistributed earnings invested in the assets of a corporation "are just as much a part of invested capital as are the dollars obtained by the sale of securities" (R. 16). The Commission rejected the contentions "on the grounds that their adoption would be unsound, without merit, inequitable, and at complete variance with established law" (R. 17).

Mr. Lundvall, who is Chief Accountant of the Federal Trade Commission (R. 334) testified as a witness for the Procurement Division that the investment in the business is not merely the amount invested in capital stock but that amount and what has been "left in the business of the company" (R. 390). He said the amount paid for capital stock is not the only investment, but it is that amount "plus whatever was left in the business from year to year" (R. 391). This witness for the Petitioner did not agree with the contentions of his counsel.

Mr. Charles W. Smith, Chief of the Bureau of Accounts, Finances and Rates of the Federal Power Commission, testified as a witness for the Public Buildings Administration and introduced Exhibit No. 45 which is reproduced at Record page 604. He testified that his exhibit showed "the cost of utility plant at the end of 1942", and that this figure "reflects the book cost of the plant" with "the average net additions for 1943" (R. 422). The witness testified that the gross investment "is the investment in the plant used and useful, averaged for the year 1943" (R. 423). After deducting con-

tributions in aid of construction "representing amounts which have not been furnished by stockholders and are other than investments by the company itself", with working capital, gives "a prudent investment rate base for 1943 of $82,740,000" (R. 423). Mr. Smith testified that "the prudent investment method is by far the best method of determining the rate base in my opinion" (R. 419). Mr. Smith included in his prudent investment rate base all of the property acquired from surplus or undistributed earnings (R. 604).

The Petitioner's statement on pages 13 and 15 of its petition that the Commission and the Court of Appeals refused to exclude from the rate base property acquired from earned surplus or undistributed earnings because of lack of power or because such action could not be sustained as a matter of law, is only one reason why the contention was rejected. It is not the principle reason for which the Commission and the court below rejected the unsupported argument. The Commission found as a matter of fact that the surplus was invested in assets used in the public service.

That the earned surplus is invested in used and useful property is not denied. The Petitioner has not contradicted this fact. It merely seeks by argument to show that because the company has had a record of good earnings, *ipso facto*, the rates have been illegal and unlawful.

The property acquired from earned surplus is included in the "Original cost of electric plant 12/31/43" shown in the table on Record page 21. In its finding of the rate base, the Commission said it "finds that the electric plant component of the gross rate base shall be the original cost of property used and useful in public service as at December 31, 1943, or $102,-434,682.29 (unweighted), and $98,633,399.89 (weighted)" (R. 19). These are the figures shown in the table on Record page 21.

The Commission having found as a fact that the earned surplus was invested in property used in service, held that both upon the facts and the law, property so acquired should

not and cannot be excluded from the value of the property. The Court of Appeals sustained the Commission's action by saying there is a clear line of authority holding that surplus invested in business is part of the "invested capital" and that it had been unable to find any contrary authority (R. 661).

Both the District Court and the Court of Appeals rejected the unsupported argument of the United States.

This court has never held directly or indirectly that property acquired from undistributed earnings should be excluded in the determination of a rate base. To the contrary, every time this Court has spoken on the subject it has held that property paid for out of revenue for services belongs to the company, just as does that purchased out of proceeds of bonds and stock. Some of such decisions are: *Board of Commissioners* v. *New York Telephone Co.*, 271 U. S. 23; *Los Angeles Gas & Electric Corporation* v. *Railroad Commission*, 289 U. S. 287; *Clark's Ferry Bridge Co.* v. *Public Service Commission*, 291 U. S. 227; *Newton* v. *Consolidated Gas Co.*, 258 U. S. 165; *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388; *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133; *Lynch* v. *Hornsby*, 247 U. S. 339; *Peabody* v. *Eisner*, 247 U. S. 347.

There is not a decision of a Circuit Court of Appeals that sustains the argument of the Petitioner that earned surplus invested in property is not a part of the invested capital. In *City of Minneapolis* v. *Rand*, 285 Fed. 818, and in *Garden City* v. *Garden City Telephone, Light & Manufacturing Co.*, 236 Fed. 693, the Eighth Circuit Court of Appeals said that it cannot be said that the utility is not entitled to the profits it has made and that it could not stop to inquire how the utility acquired title to the money invested.

In *Flynn* v. *Haas Bros.*, 20 F. (2d) 510, 511, the Eighth Circuit Court of Appeals said invested capital means "* * * and (3) paid in or earned surplus and undivided profits used or employed in the business; * * *."

In *Eaton* v. *English & Mersick Co.*, 7 F. (2d) 54, the Second Circuit Court of Appeals said that surplus used in the business is "invested capital".

The ground upon which the United States asks this Court to grant a writ of certiorari is directly contrary to the position taken by the Assistant Attorney General before the Court of Appeals for the District of Columbia and that court's decision in *Geo. Feick & Son Co.* v. *Blair*, 58 App. D. C. 168, 26 F. (2d) 540, 541, where it was conceded that the amount of accumulated dividends should not be excluded from invested capital (Page 541). The court held in that case that the surplus remained as property of the corporation to be used in its business "and as such is part of its invested capital" (Page 542).

The State Courts have held contrary to the argument made by the Petitioner. *Peoples Natural Gas Co.* v. *Pennsylvania Public Utilities Commission*, 34 A. (2d) 375, 153 Pa. Super, 475; *State* v. *Hampton Water Works Co.*, 18 A. (2d) 765, 91 N. H. 278; *City of Cincinnati* v. *Public Utilities Commission*, 148 N. E. 817, 113 Ohio St. 259; *Michigan Public Utilities Commission* v. *Michigan State Telephone Co.*, 200 N. W. 749, 228 Mich. 658.

In *Fall River Gas Works Co.* v. *Board of Gas & Electric Light Commissioners*, 102 N. E. 475, 480, 214 Mass. 529, the court said when a utility has surplus earnings they belong to the corporation and not to the public.

In *Grafton Electric Light & Power Co.* v. *State*, 94 A. 193, 195, 77 N. H. 539, counsel for the Public Utilities Commission of the State of New Hampshire made the same argument that the Petitioner made in the court below and is making here, because, as he contended, the public had some vague interest in the utility's surplus which had been accumulated. The court said:

> "Since it is their property, it cannot be taken from them directly, nor can they be deprived of it indirectly, either in whole or in part, by denying to its owners the right to use it as they could use their own property."

In *Gibbons* v. *Mahon*, 136 U. S. 549, 34 L. ed. 525, this Court said that reserved and accumulated earnings held and invested by the corporation were a part of the corporate property, and that whether profits should be invested or distributed is a matter to be determined by the corporation. In *Eisner* v. *Macomber*, 252 U. S. 189 (which the United States in *Helvering* v. *Griffiths*, 318 U. S. 371, asked this Court to reconsider and over-rule, which request was denied) this Court said every dollar of original investment, together with whatever accretions and accumulations have resulted from employment of money, still remains property of the corporation.

In footnote 13 on page 16 of the petition, it is said that the Securities and Exchange Commission assumed in *Re: Potomac Electric Power Co.*, 8 S. E. C. 30, 36, that it was discussing surplus accumulated from fair and reasonable rates. The Securities and Exchange Commission was discussing the same surplus that the United States discussed in its petition. In that proceeding before the Securities and Exchange Commission, the United States made substantially the same argument that it made in the court below and is making here. The Securities and Exchange Commission did not agree with the contention.

The exclusion from the rate base of property acquired from undistributed earnings would be a clear violation of Paragraph 7 of the Act (37 Stat. 978) that the Commission shall value the property "actually used and useful for the convenience of the public at the fair value thereof at the time of said valuation". Such exclusion would be a clear violation of the Federal Constitution.

The Petitioner has modified its argument by now contending that the Commission should have excluded all of the surplus "or a portion thereof" (Pages 3 and 10). The Petitioner apparently now takes the position that if it cannot have all, there is no harm in asking for less.

The difficulty with the position of trying "to settle for less" is, that there is no basis in the record for half measures. When the Petitioner was before the Commission through two agencies, and before the lower courts, it contended that all of the surplus was "illegal" (R. 16, 55, 659, 661). But it offered no evidence that any part of the surplus was illegal. Before the Commission it contended there should be excluded from the rate base "an amount of property equal to Pepco's earned surplus" (R. 15, 16, 232). It made the same argument before the Court of Appeals (R. 659, 661). This fact was noted by the Court of Appeals in footnote 33, Record page 662. Perhaps this is the reason the Petitioner now is willing to settle for less.

The reasons advanced in the petition for the granting of a writ of certiorari are based solely upon argument that is contrary to the evidence in the record. It is contrary to the testimony of witnesses for the United States; it is contrary to witnesses of the Commission; and is contrary to the findings of fact of the Commission. It is contrary to the decisions of the District Court and of the United States Court of Appeals. The Petitioner's position is not even based upon opinion testimony. In *Dayton Power & Light Co.* v. *Public Utilities Commission*, 292 U. S. 290, this Court said that opinion testimony had evidentual value but nothing more. It has no such commanding quality as to apply coercion to the judgment of the appointed triers of the facts. If opinion evidence has no such commanding quality, is pure "argument", based upon erroneous conclusions, sufficient to coerce the judgment of a regulatory body?

In footnote 11 on page 14 of the petition, the Petitioner says the company's "actual investment" was $2,245,000 from 1925 to 1942, and $5,245,000, thereafter. Elsewhere in the petition, these amounts are referred to as the "actual investment". This statement is contrary to the evidence. It is contrary to the testimony of witness Charles W. Smith for the United States (R. 422, 423, 604); it is contrary to the testi-

mony of the Commission's Executive Accountant and Auditor (R. 290, 291, 589); it is contrary to the testimony of Mr. Arthur E. Lundvall, Chief Accountant for the Federal Trade Commission who appeared as a witness for the Procurement Division of the Treasury (R. 390, 391, 392); it is contrary to the Commission's finding of fact (R. 9, 19, 21, 35).

From this misstatement of the actual investment, the Petitioner draws erroneous conclusions about the earnings under the sliding-scale arrangement. These conclusions are contrary to Petitioner's witnesses Smith and Lundvall and its witness Professor Bonbright (R. 412). It constructs from these erroneous conclusions the tables in Appendix "A" of the petition.

The conclusions stated by the Petitioner on page 14 and subsequent pages and in Appendix "A" are contrary to the decision of the Court of Appeals when it was discussing the same contention below, and said:

> "However, this analysis provides but one of the types of information which the Commission must take into account in arriving at a 'reasonable' rate. These earnings, in percentages, are meaningful only when they are related to the Company's total capital structure" (R. 661).

The argument made by the Petitioner and the erroneous conclusions it draws concerning the relationship of earnings to par value of common stock are contrary to decisions of regulatory bodies generally, and contrary to authorities on the subject.[2]

Courts have universally held that proceeds from surplus or depreciation reserve or any other source invested in assets constitute part of invested capital. Cases cited, *supra*, and *Miles* v. *Safe Deposit Co.*, 259 U. S. 247; *Bailey* v. *N. Y. C. & H. R. R. Co.*, 89 U. S. 604, 22 L. ed. 840; *Martindell* v. *Fidu-*

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[2] "The Economics of Public Utility Regulation", Barnes, Page 265; "Financial and Operating Ratios in Management", Bliss, Pages 58, 75; "Public Utility Finance", Lagerquist, Page 567.

ciary Counsel, 30 A. (2d) 281, 133 N. J. Eq. 408; *People Ex rel Fraser* v. *Great W. Sugar Co.,* 29 F. (2d) 810.

On page 17 of its petition, the Petitioner says that Pepco's surplus "represents amounts accumulated as the result of illegal and improper depreciation practices and of exorbitant earnings". On the intervening pages and again on page 21, the Petitioner makes the same unwarranted statement.

On pages 19 and 20, the Petitioner quotes only a part of Paragraph 16 of the Act and from that argues that the sliding-scale plan and the Commission's application of it "violated the basic depreciation principles established in Pargraph 16".

In *Washington Gas Light Company* v. *Byrnes,* 78 U. S. App. D. C. 107, 137 F. (2d) 547, and in *Vinson* v. *Washington Gas Light Company,* 321 U. S. 489, the United States made precisely the same argument where the sliding-scale there involved provided, as does the one here involved, for accrual of 4% interest on the depreciation reserve as an accretion thereto, and thereby a lessening of the amount of depreciation to be included in the annual expenses of operation. As pointed out by both the Court of Appeals and this Court, the argument in that case was premised primarily upon *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U. S. 575. Both Courts rejected that argument. This Court said the argument was "unsupported by our cases".

The assumptions upon which the Petitioner bases its argument that the Commission has violated the provisions of Paragraph 16 are contrary to evidence of record. Charles W. Smith, who testified as a witness for the Commission on the subject of depreciation and depreciation charges, and later as a witness for the Public Buildings Administration upon a prudent rate base, testified that the practice of the Commission under the sliding-scale plan did not permit the company to accrue a sufficient depreciation reserve (R. 368, 397). He did not agree with the position taken by the Petitioner as to the applicability and meaning of Paragraph 16 (R. 368, 374, 377, 380, 397). As a witness for the Public Buildings Administra-

tion, Mr. Smith testified that the average reserve for depreciation in 1943, which he deducted from the gross base to determine the prudent investment rate base, was $17,782,057 (R. 604). While Mr. Smith testified that the sliding-scale plan had not provided a sufficient reserve requirement, he recommended that the book reserve be deducted in determining the rate base (R. 368, 369, 397).[3]

In spite of the assertion on pages 17 and 21 of the petition that the Company's surplus represents amounts accumulated as the result of illegal and improper depreciation practices, the Petitioner alleged in its complaint in the District Court that Paragraph 16 of the Act "requires that $14,000,000 be added to the depreciation reserve and so included in the amount to be deducted from the gross rate base in arriving at the base on which a return was to be allowed" (R. 52).

Before the plan was modified, depreciation reserve was treated by the Commission as a source of funds (R. 22, 589). The 4% interest credit to that reserve was considered by the Commission as a part of the cost of funds and was, therefore, given its proper weight in the determination of a proper rate of return. The Commission found that "By using an undepreciated rate base and deducting interest on the reserve balance from the depreciation accruals, and giving effect to the interest rate applied to the reserve in fixing the rate of return, the result obtained is the same as that arrived at by the use of a depreciated rate base" (R. 22). Since the result is the same under either method, it follows that Petitioner's contention is wholly without merit.

II

The Sliding-Scale Arrangement Is a Reasonable and Lawful Method of Rate Adjustment

The assertion by the Public Buildings Administration that the sliding-scale arrangement was adopted pursuant to a de-

[3] Professor Bonbright who was also a witness for the United States testified that the depreciation reserve accumulated under the sliding-scale plan was inadequate (Page 2200 of the Transcript).

sign and conspiracy to establish a device to extract unlawful and unreasonable rates and was so tolerated by the members of the Commission, (R. 505 and 507) is disproved by the record of achievment under the plan. The undisputed record of reductions in rates and the lessening in the cost of electric service, noted on page 7 and 8, *supra*, speak a denial of the assertions of this agency.

The charge made is contrary to the testimony of the only witness called by the Public Buildings Administration (R. 378, 379, 395, 396). It is also contrary to the testimony of Professor Bonbright (R. 408). It is contrary to the belief expressed by the consumers through the Federation of Citizens Associations (R. 10) and the People's Counsel.

In the Preface to his "Public Utility Regulations and the So-Called Sliding Scale", Mr. Bussing said that before the adoption of the sliding-scale arrangement, electric prices in the District of Columbia "were among the highest in the country; within eight years they were among the lowest." On page 126 he said that while the company's earnings have remained consistently above the basic rate, notwithstanding the fact the price to consumers has dropped from among the highest in the United States to one of the lowest. On pages 137 and 138 Mr. Bussing shows cumulative savings under the sliding-scale plan from 1925 to 1935, inclusive, of $37,020,372. Mr. Bussing stated that the actual savings to the consumers have been greater than these figures indicate, for the latter are based on the assumption that consumption in the ensuing year would be no greater than it was in the previous period.

On page 18 of the Petition, the Petitioner says the actual excess earnings to the company are many millions of dollars greater than the $16,000,000 stated by the Commission on Record page 8 because under the Commission's practice excess earnings "was immediately added to the rate base".

This statement is not true. From the time the plan was adopted, to the initial rate base each year "there has been added the actual cost of subsequent net additions" (R. 12,

18). Under the sliding-scale arrangement for the determination of gas rates where the identical method of determining the rate base is employed, the Court of Appeals in *Washington Gas Gas Light Co.* v. *Byrnes*, 78 U. S. App. D. C. 107, 109, 137 F. 2d 547; and this Court in *Vinson* v. *Washington Gas Light Co.*, 321 U. S. 489, 492, said that the sliding-scale plan requires the rate base to be adjusted annually by adding net property additions at cost.

Contrary to the contention of the Public Buildings Administration that the sliding-scale arrangement was a device to extract from consumers unjust rates (R. 505), its witness, Mr. Smith, said, "I envy the sliding-scale arrangement because it has benefits to the public as compared to the typical fair-value procedure." (R. 396). The witness narrated some of the benefits of the sliding-scale arrangement (R. 378, 379, 398).

Professor James C. Bonbright of New York City, Economist, Professor of Finance in the Business School of Columbia University and specialist in public utility matters, who was called as a witness by the Procurement Division of the Treasury (R. 406), recommended certain modifications of the sliding-scale arrangement and stated "that the sliding-scale plan deserves substantial credit, both for the promptness and for the amount of the reductions in residential rates" (R. 408).

III

No Good Reason Is Advanced for Issuing a Writ of Certiorari

The Petitioner seeks a review of the decision below on nothing more than its argument that rates charged for electric service since January 1, 1925, have been illegal. The lower court said it is only by saying retroactively that the rates extracted in former years were not just and reasonable, that it could conclude that the surplus or undistributed earnings was an unlawful accumulation (R.659). All of the evidence shows

that surplus is actually invested in property used in the public service.

The decision of the lower court is not in conflict with any decision of this Court. Indeed, it is in accord with this Court's decision in *Vinson* v. *Washington Gas Light Co., supra.* The decision is not in conflict with that of any other Circuit Court of Appeals.

This is not a case of reviewing the statute for the first time. This Court construed paragraph 16 of the statute here involved in *Vinson* v. *Washington Gas Light Co., supra,* against the same attack that is made against it in the instant Petition. This Court also construed a sliding-scale plan adopted under the same paragraph of the Act as the one here involved.

No sufficient reason is advanced for granting a Writ of Certiorari.

CONCLUSION

It is respectfully submitted that the Petition for Writ of Certiorari should be denied.

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